

# **Oregon's Trail to Retirement System Reform**

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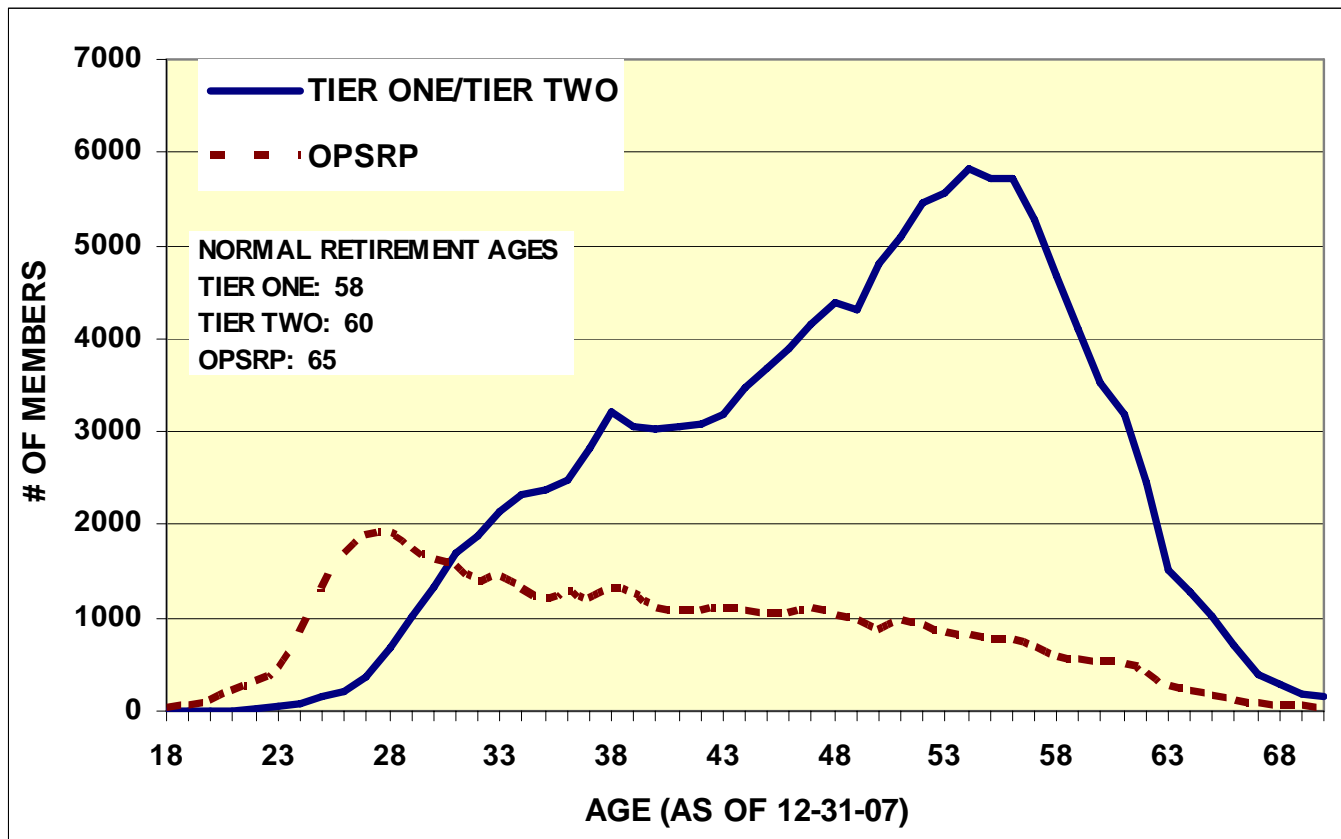
**Kentucky Pension Reform Work Group**

# Oregon PERS

- Statutorily created in 1946
- 870 employers; 95 percent of Oregon's public employees – state, local government, and schools
- \$59 billion fund (as of August 31, 2008); one of nation's largest retirement funds
- Oregon Investment Council; top tier investment performance
- Investments generated 85 percent of 2007 revenue
- PERS Board: governance and policy oversight

# Oregon PERS (continued)

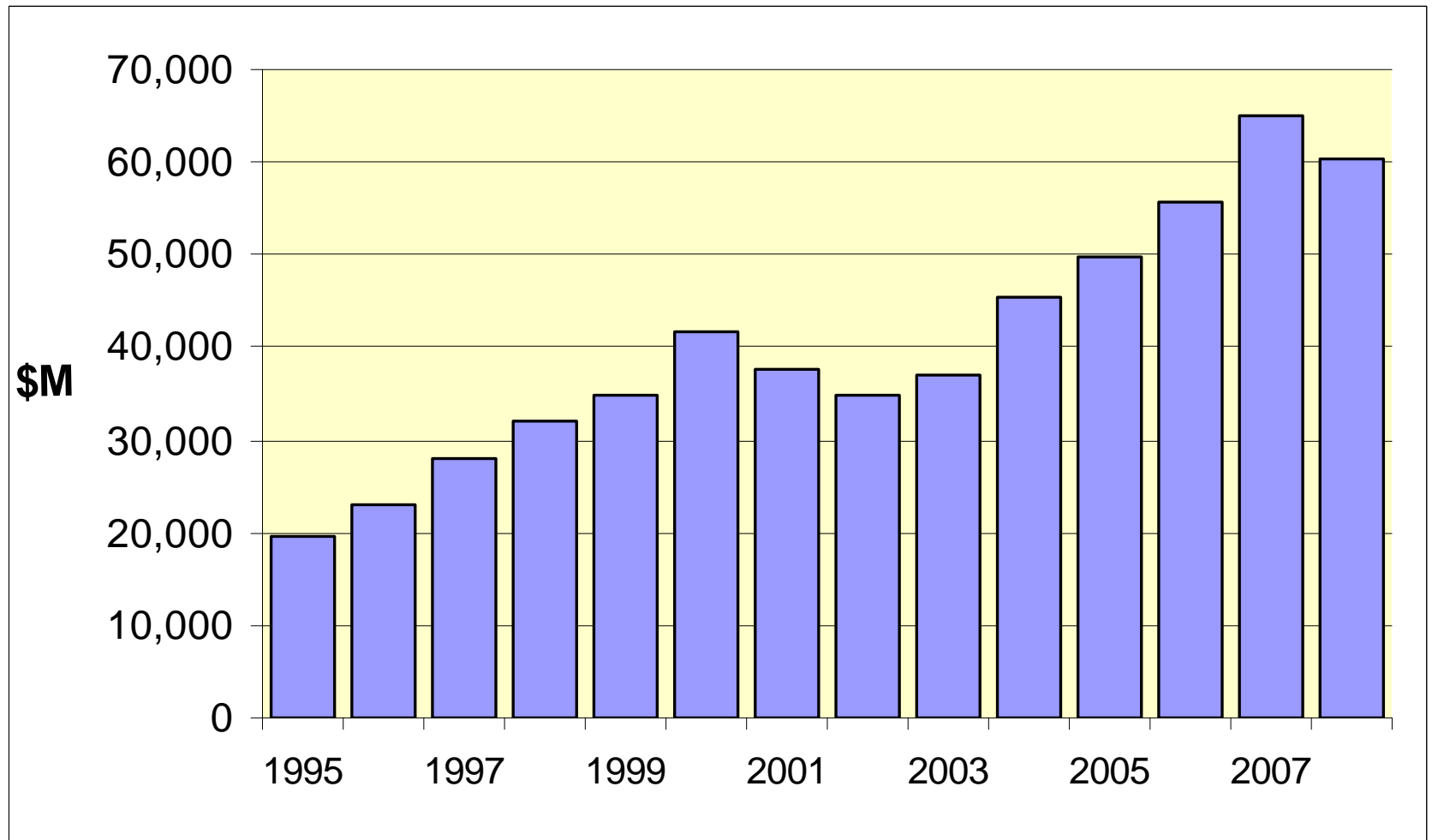
- 320,000 members and retirees: 167,000 active; 48,000 inactive; and 105,000 retirees
- 55,000 eligible to retire by age or service



# Oregon PERS (continued)

- Average 6,000 retirements per year; peaked at 12,500 in 2003
- Average annual benefit for FY 2007 retirees: \$27,000
- Average annual benefit for all living retirees: \$23,300
- \$2.4 billion paid annually to retirees living in Oregon; \$300 million in 49 other states and \$6 million in 47 other countries

# Net Plan Assets (Fiscal Year Ending June 30)



# The PERS Trail Before Reform

- Members get “best of three” benefit calculations: Full Formula, Formula Plus Annuity, and Money Match
- “Money Match” benefit doubles member accounts at retirement
- Members received high earnings in good years and guaranteed 8 percent earnings in bad years
- Actuarial factors not kept current
- \$17 billion unfunded actuarial liability (UAL) emerges

# The PERS Trail Before Reform (continued)

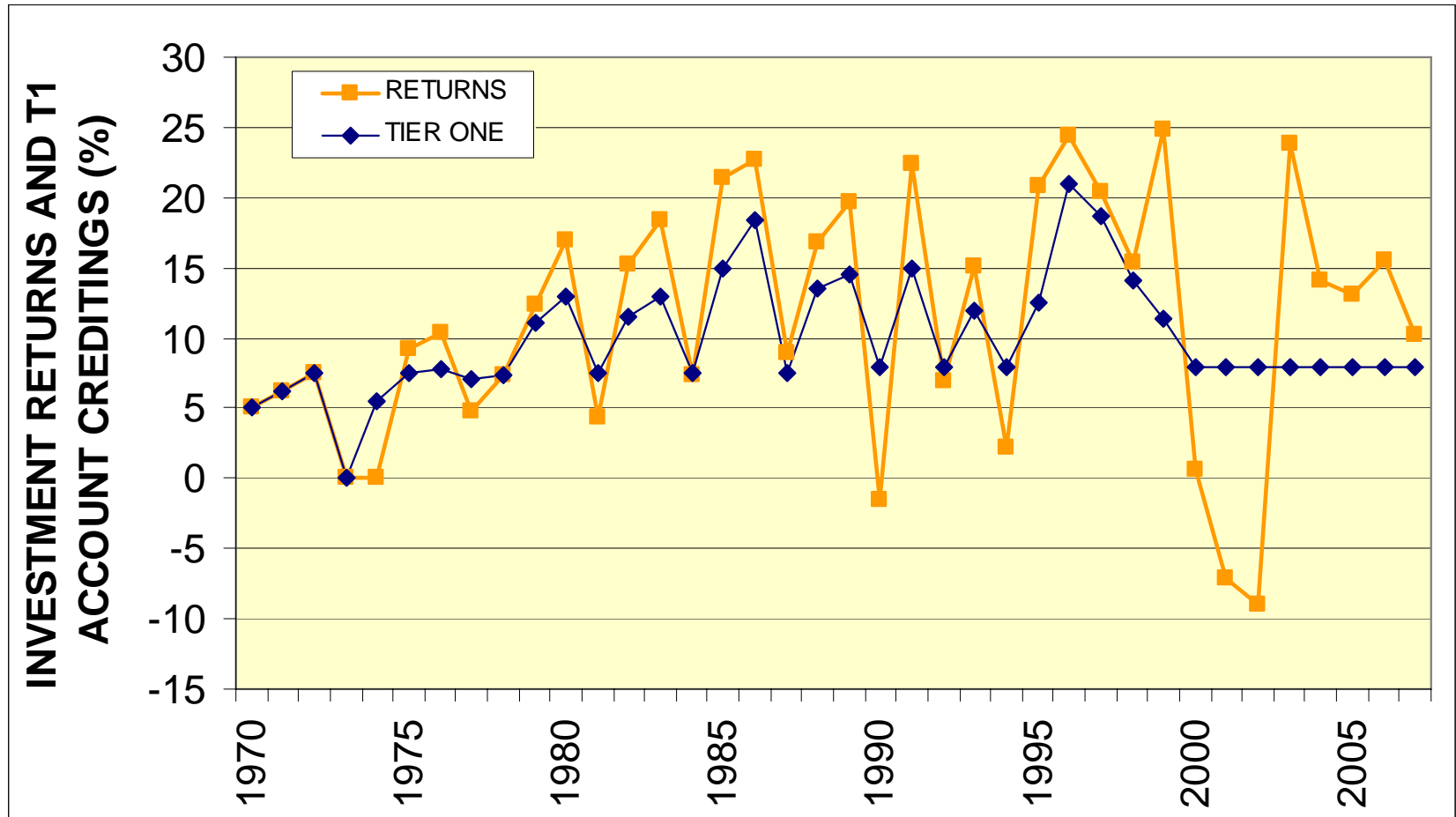
- Earnings crediting in good years doubles member accounts several times within a short time span

Year	1996	1997	1998	1999
Account crediting (%)	21.0	18.7	14.1	20.0

- Money Match benefits soar; becomes predominate retirement calculation
- Tier One accounts receive 8 percent “guarantee” during 2000-2002 market downturn

# The PERS Trail Before Reform (continued)

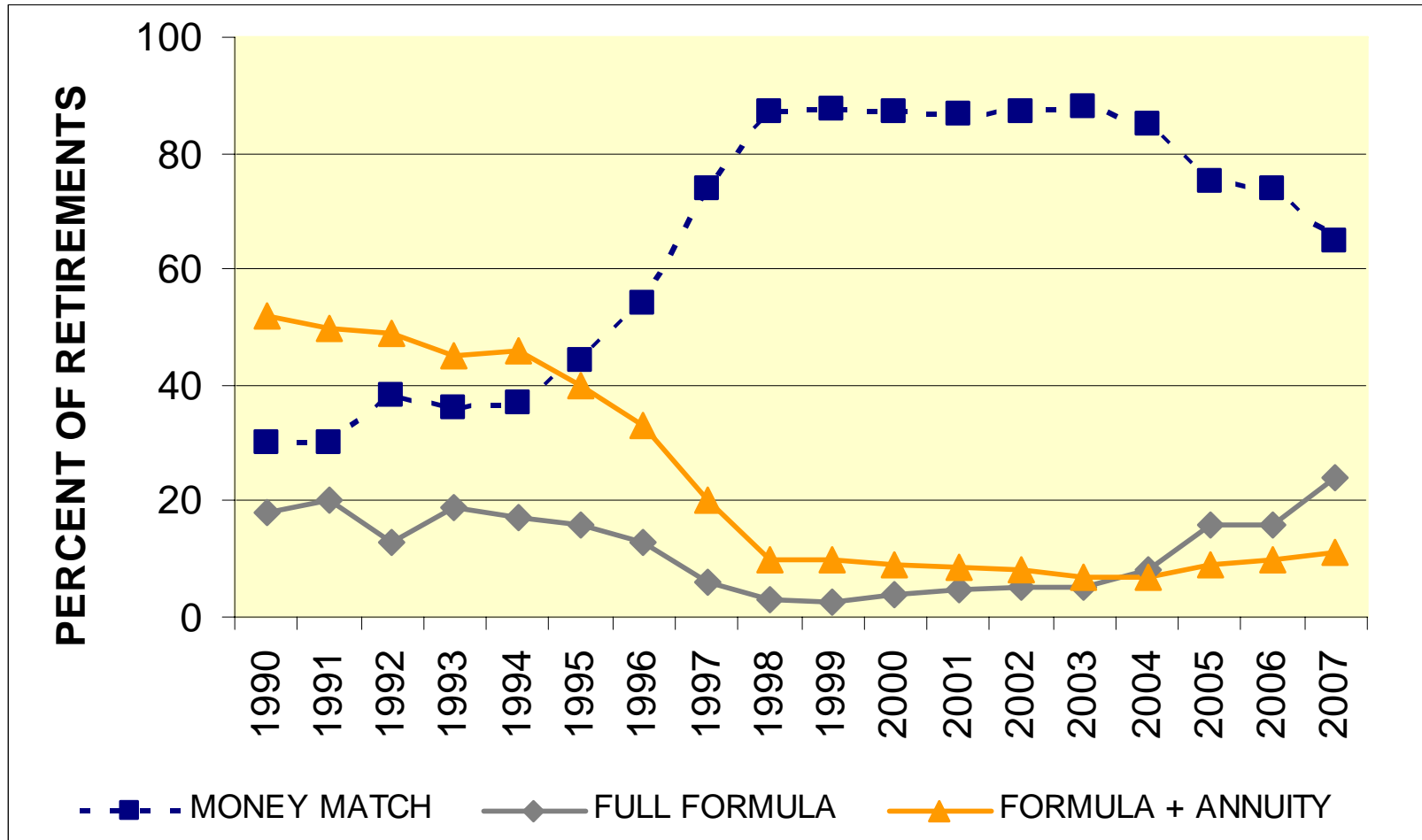
Earnings crediting to Tier One accounts





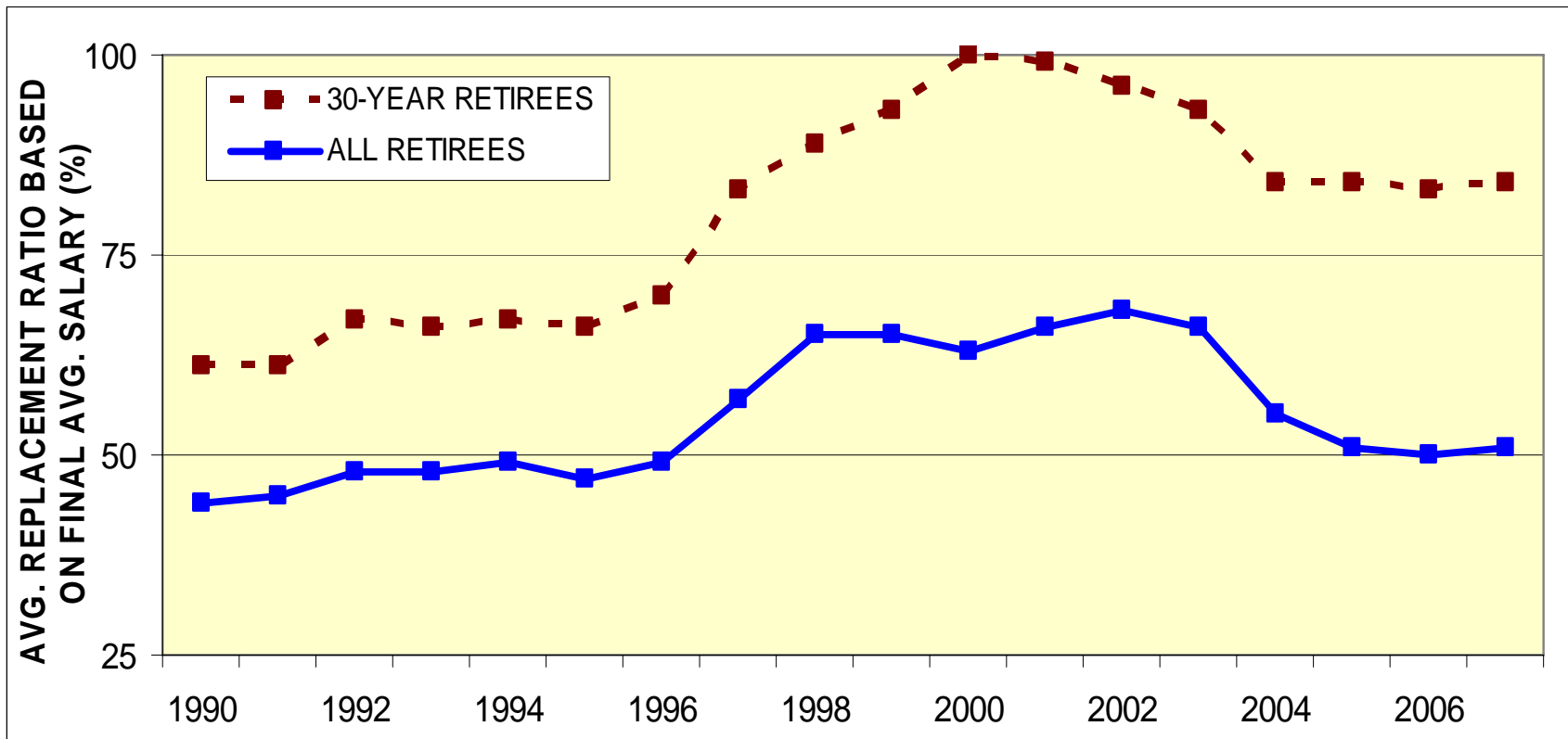
# The PERS Trail Before Reform (continued)

## Retirement benefit calculation trends



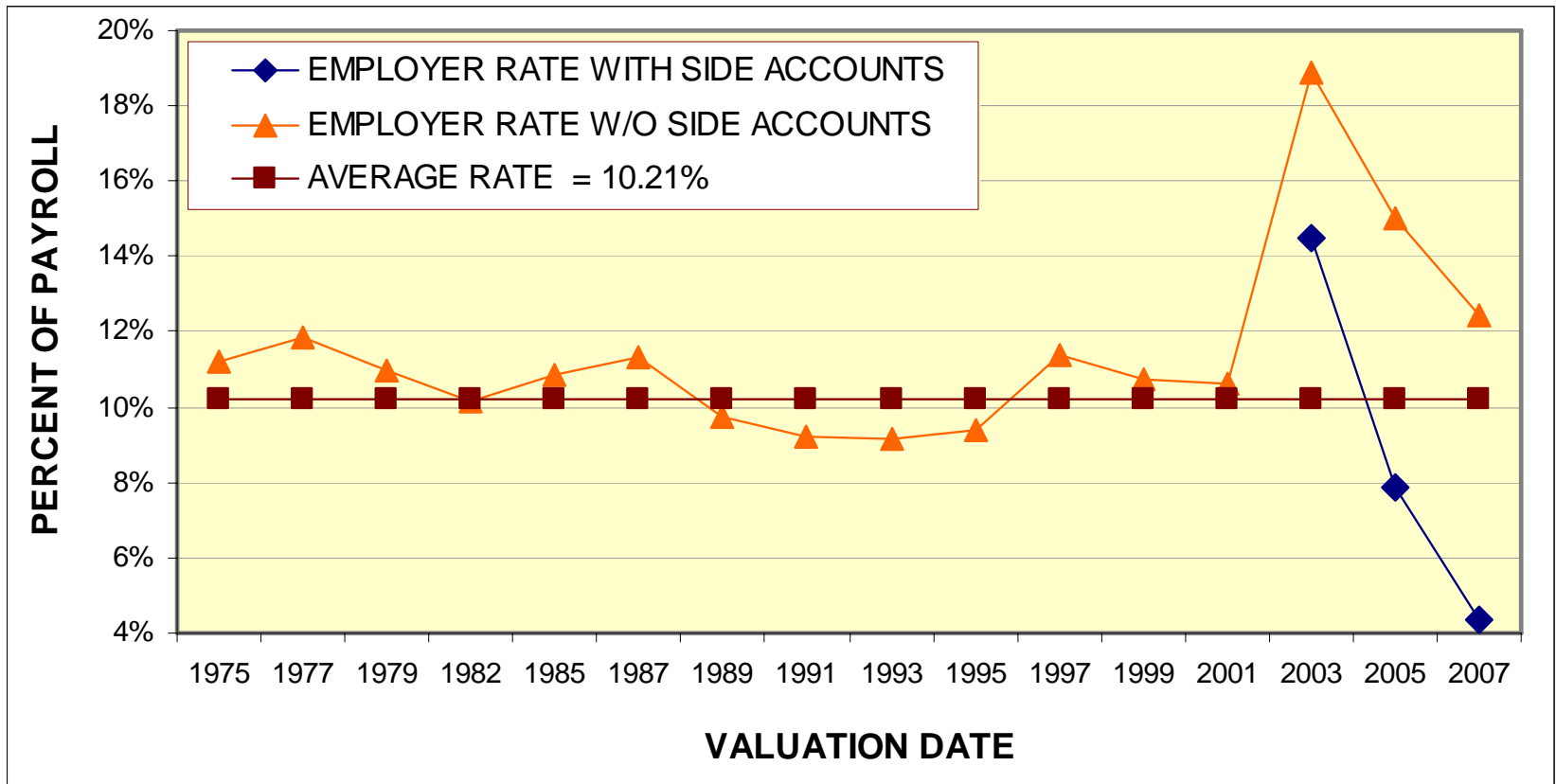
# The PERS Trail Before Reform (continued)

- Investment losses and increasing liabilities create \$17 billion UAL (65 percent funded)
- PERS retirement benefits approach or exceed final salaries



# The PERS Trail Before Reform (continued)

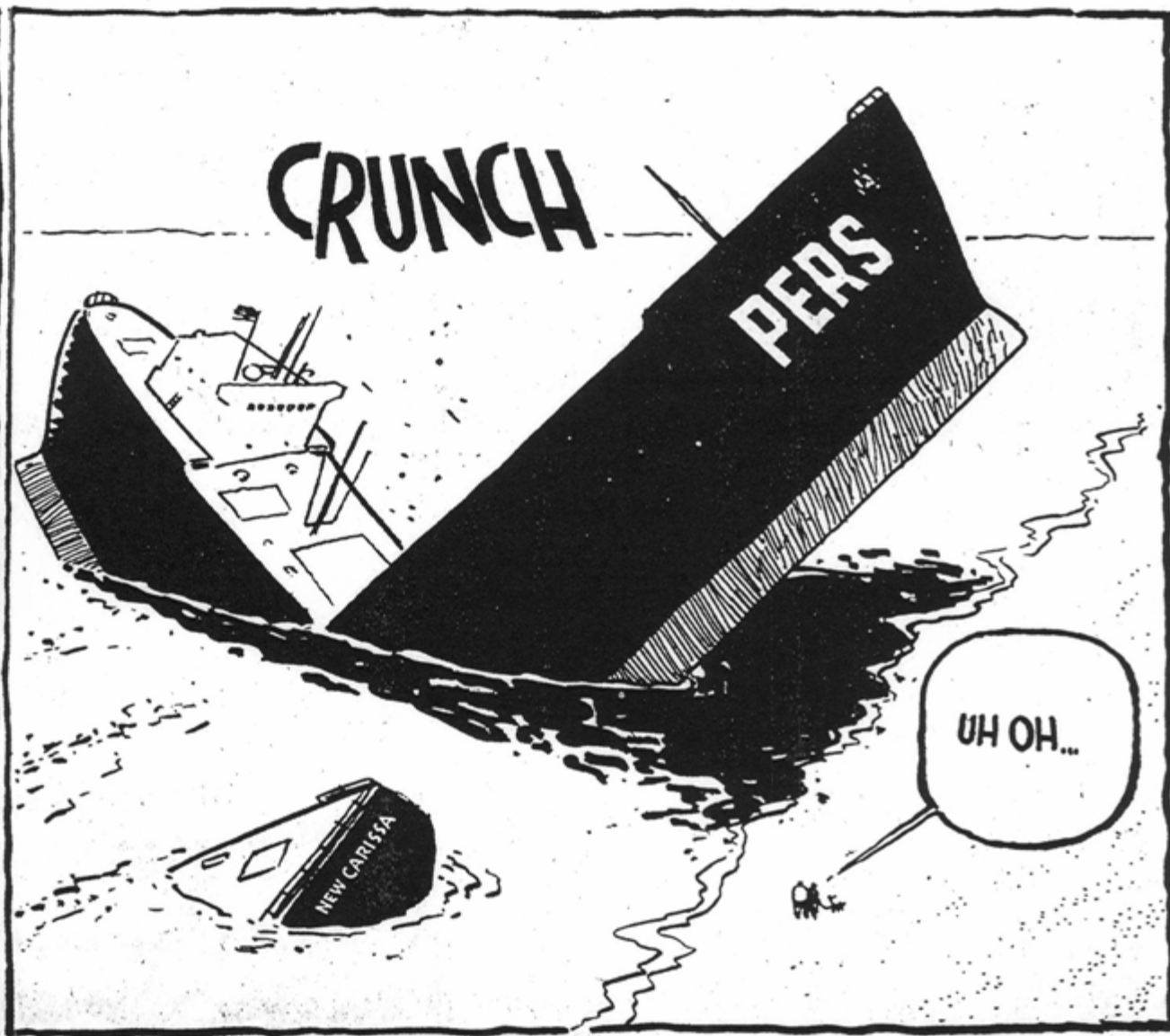
- Employer rates projected to increase to 27 percent of covered salary; each percentage point equals \$70 million per year



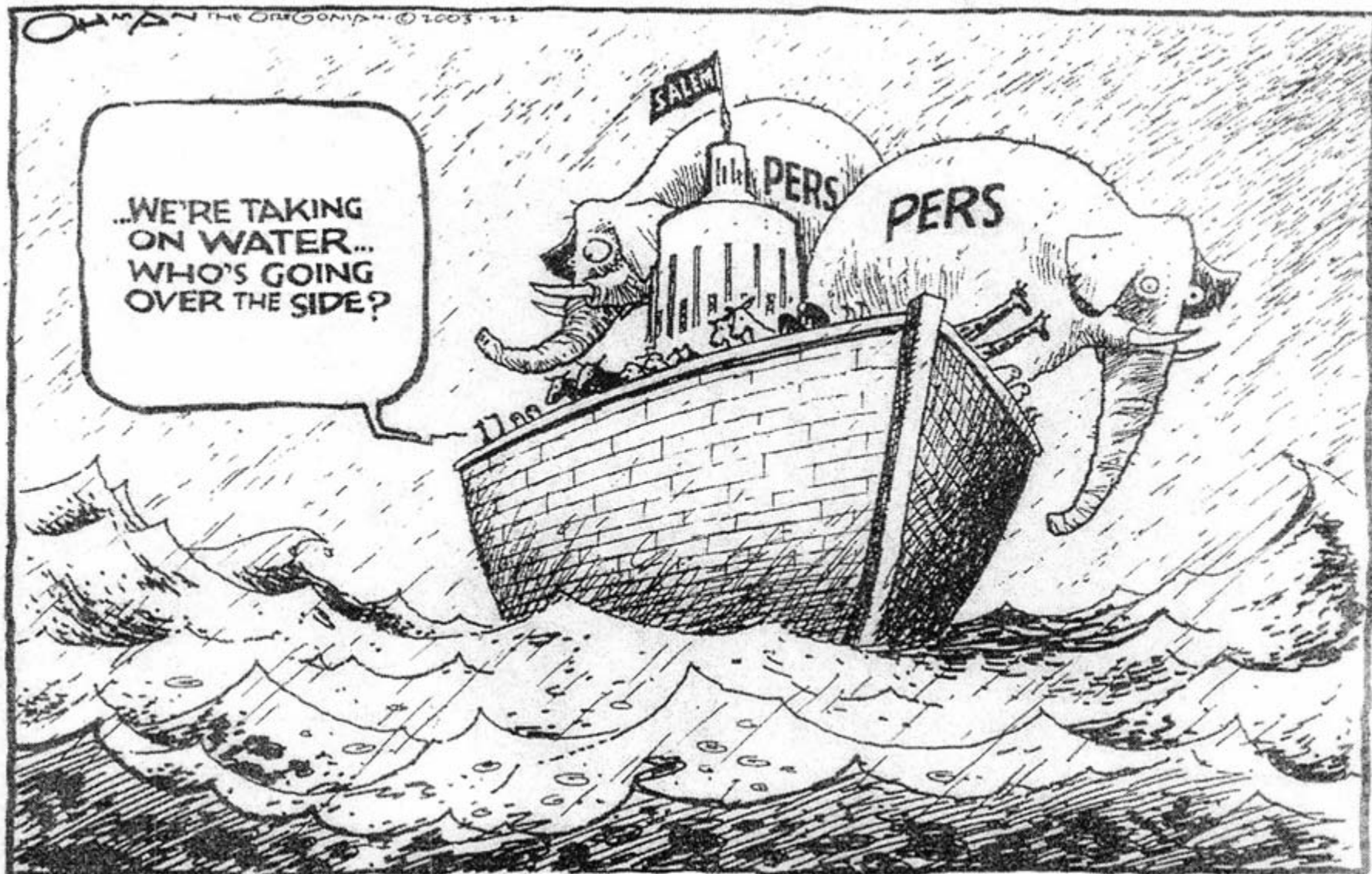
- PERS becomes a major issue in 2002 Governor's race and top legislative issue in 2003 session

# Pre-PERS Reform Headlines

- “Soaring price of PERS bludgeons public agencies”  
*Oregonian, 2002*
- “New PERS costs rock public sector”  
*Oregonian, 2002*
- “PERS rate hike outrageous”  
*Oregon Public Broadcasting, 2002*
- “PERS rates to skyrocket in 2003”  
*Statesman Journal, 2002*
- “PERS shortfall empties piggy bank for services”  
*Statesman Journal, 2003*







THE 28 DAYS AND 28 NIGHTS OF OREGON FLOODS...











# PERS Reform Changes and Timelines

**January - August 2003:** PERS reform bills enacted

**July 2003:** Updated actuarial factors developed and applied

**July 2003:** COLAs frozen for 21,000 retirees

**August 2003:** Oregon Public Service Retirement Plan (OPSRP) implemented for new public employees

**September 2003:** Five-member Board replaces 12-member

**January 2004:** Six percent member contribution redirected to new Individual Account Program (IAP)

**2003 and 2004:** No regular account earnings credited to Tier One members

# Trail Switchbacks: Reform Laws Challenged

**March 2005:** Oregon Supreme Court's *Strunk* ruling **upholds** three key PERS reforms:

- Actuarial factors required to be kept current (reviewed every two years)
- Member contributions redirected to Individual Account Program (market returns with no guarantee or employer match)
- Tier One earnings crediting restrictions and reserve requirements (earnings over 8 percent now reserved for bad years)

# Trail Switchbacks: Reform Laws Challenged

**March 2005:** Oregon Supreme Court's *Strunk* ruling **overturns** PERS reforms that:

- Prohibited earnings crediting to Tier One members in bad years (PERS must credit 8 percent annually)
- Froze retirees' COLAs to recover 1999 earnings overcrediting (PERS must grant COLAs annually)

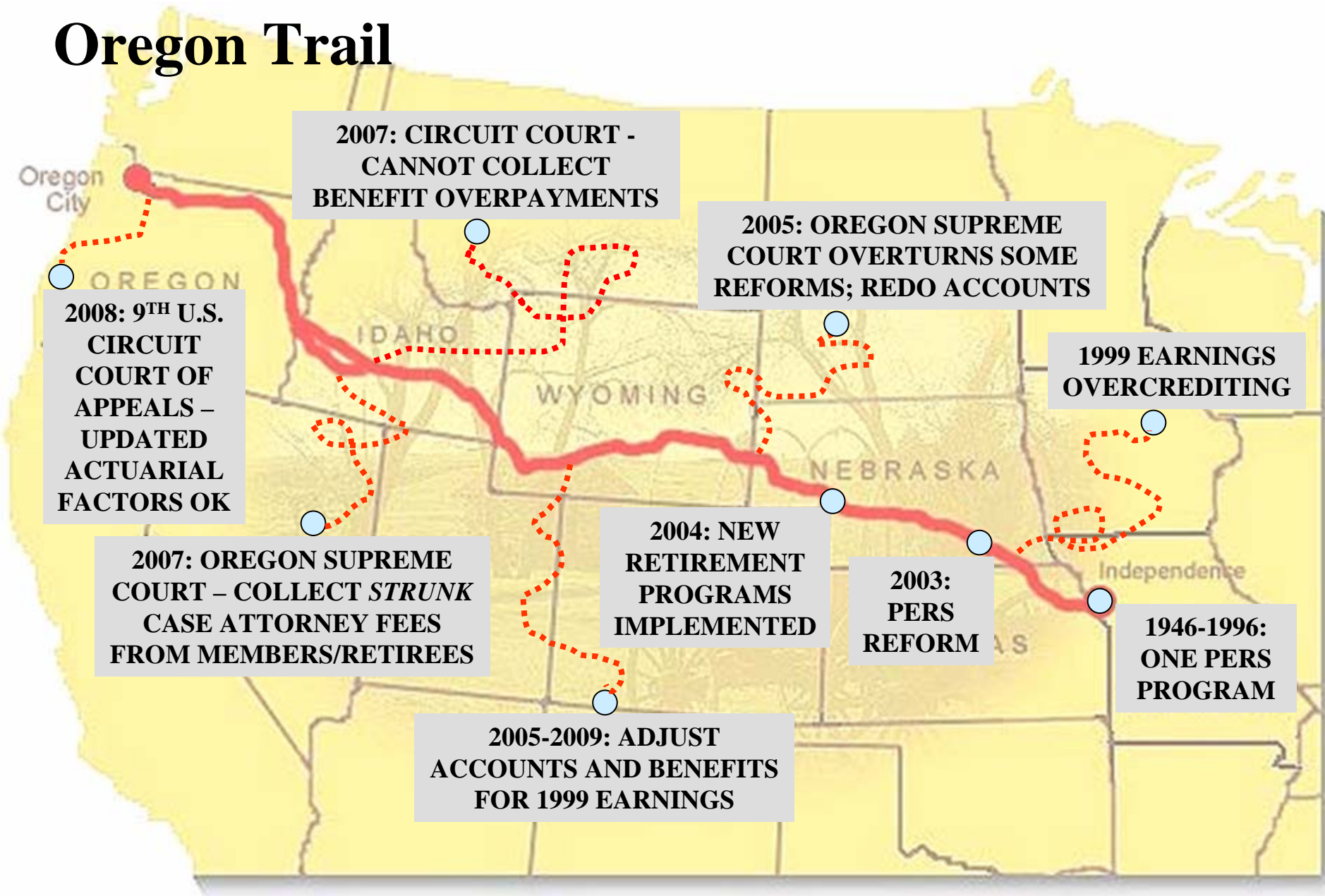
# Backtracking on Trail: *Strunk/Eugene* Project

**2005-2009:** Oregon Supreme Court decisions and Settlement Agreement require PERS to:

- Reduce 1999 earnings crediting from 20 to 11.33 percent for 150,000 members and retirees
- Credit 8 percent to Tier One members for 2003 and 2004
- Recalculate 45,000 benefits to reflect revised earnings crediting
- Reinstate COLAs for retirees that were frozen









# Oregon Trail



# New Trail: PERS' Retirement Plan Components

- One major program for 50 years
- Three major programs added since 1996; two in the last five years

Hire date	Plan			
	Tier One	Tier Two	OPSRP Pension Program	Individual Account Program
Before January 1, 1996				
January 1, 1996 thru August 28, 2003				
August 29, 2003 or after				

- All members now participate in two programs, with up to three different accounts (regular, variable, Individual Account Program)

# Four Retirement Programs

<b>Program</b>	<b>Type of Member Benefits</b>	<b>Member Account(s) Subject to Losses</b>	<b>Benefit Calculation Methods</b>	<b>Formula Factors (final average salary x years of service x factor set by statute)</b>	<b>Full Formula Salary Replacement (30-Year Career)</b>
Tier One	Hybrid DB/DC	Yes for DC & variable; no for regular account	Money Match, Full Formula, Formula + Annuity	1.67% general service; 2.0% police & fire (1.00% general service; 1.35% police & fire for Formula + Annuity)	50%
Tier Two	Hybrid DB/DC	Yes	Money Match, Full Formula	1.67% general service; 2.0% police & fire	50%
OPSRP Pension Program	DB	N/A	Full Formula	1.50% general service; 1.80% police & fire	45%
Individual Account Program	DC	Yes	N/A	N/A	~15-20% (projected at 8% annual return)



# IAP Created by Legislature (2003)

- Provided a compromise middle ground between defined contribution versus defined benefit proposals
- Allowed a greater portion of investment risk to be shared with members
- Stabilized Money Match liability for legacy Tier One and Tier Two members by slowing growth of legacy member accounts
- Integral part of the defined benefit plan created under the new OPSRP program
- Approximately 206,000 participants since January 1, 2004 (167,000 active; 35,000 inactive)

# IAP Funding and Distribution

- Member contributes 6 percent of salary
- Contributions for existing members began January 1, 2004
- New members begin contributions after a 6-month waiting period and must work in a qualifying position (600 hours per year; can be for multiple concurrent employers, e.g., substitute teachers)
- Annual contributions averaged \$430 million since program inception
- Total IAP account value was \$2.15 billion as of December 31, 2007
- Retirees receive lump-sum payout or installment payments over 5, 10, 15, or 20 years (monthly, quarterly, or yearly) or over anticipated lifetime expectancy. Each distribution must be at least \$200

# IAP Investment and Crediting

- Invested as part of overall PERS Fund; diversified, long-term portfolio
- Annual earnings crediting based on overall portfolio returns net of investment and administrative expenses
- No self-directed investment
- Returns net of expenses averaged 12.5 percent from 2004-2007

2004	2005	2006	2007
12.77%	12.80%	14.98%	9.46%

- 2008 returns through August 31, 2008 were negative 7.49 percent

# IAP Administration

## External

- Third party administrator (TPA) for record keeping, account website, distribution processing, and tax reporting

## Internal

- Employer reporting and prior period adjustments processing
- Contributions, employer billing and collection, and transfer to State Treasury for investment
- Intake and processing for account withdrawal and retirement applications
- Customer service delivery, annual statements, and issue resolution

# IAP Lessons Learned

- Membership eligibility screening results in a large number and variety of prior period adjustments
- Problems with electronic employer reporting and complex membership eligibility rules can lead to uneven contributions and earnings disputes
- Flat-rate administrative cost deductions in early years appeared excessive and onerous (now deduct administrative costs before earnings crediting)
- Split administration (internal and TPA) has been challenging for all aspects of program, particularly distribution processing and related customer service
- Insufficient program planning and development timeframe (four months) required major remediation in the program's second year

# Oregon's Trail Pays Off

- Reforms plus good earnings and pension obligation bonds close \$17 billion UAL hole in three years
- System funded at 112 percent with another \$2.5 billion in reserves as of December 31, 2007
- Employer rates peaked at 15 percent; will range from 5 to 12 percent in 2009
- Named “2007 Public Plan Sponsor of the Year” and declared “the best funded pension system in the country”
- System still vulnerable to investment return volatility but better able to get ahead with good earnings and absorb poor earnings

# New Compass Headings

- Consider all interests in meeting fiduciary obligations
- Provide predictable and stable employer rates
- Protect funded status by critically evaluating assumptions
- Maintain equity across generations of taxpayers
- Be an accurate and credible information source
- Make decisions in an open, transparent manner
- Provide adequate, affordable, and sustainable retirement benefits
- Remember that all pension systems pay retirement benefits. Beyond that, any resemblance may be purely accidental

# Lessons Learned on Oregon's Trail

- The quickest way out of hole is to first stop digging
- It ain't what you don't know that gets you in trouble, it's what you know for sure that just ain't so
- If you're riding ahead of the herd, take a look back now and then to make sure it's still there
- Never kick a cow chip on a hot day
- Always drink upstream of the herd
- There are two theories on arguing with a retiree - neither one works
- Nothing very good, or very bad, lasts very long